No. 92-854

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

CENTRAL BANK OF DENVER, N.A.,
Petitioner,
v.
FIRST INTERSTATE BANK OF DENVER, N.A. and
JACK K. NABER,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER CENTRAL BANK OF DENVER, N.A.

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QUESTIONS PRESENTED

1. Whether there is an implied private cause of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?

2. Whether recklessness satisfies the *scienter* requirement for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER CENTRAL BANK OF DENVER, N.A.

PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae*, pursuant to Rule 37.3 of the Rules of this Court, in support of petitioner Central Bank of Denver, N.A. ("Central Bank").[1]

INTEREST OF THE INSTITUTE AS *AMICUS CURIAE*

The Institute is the national organization of the certified public accounting profession, with more than 310,000 members. Among the Institute's objectives are the promotion and maintenance of accounting, auditing, and ethical standards of practice. As the authoritative source of these standards, the Institute has a profound interest in the scope and bases of civil liability sought to be imposed on accountants in connection with their professional services under the rubric of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ("Section 10(b)" and the "1934 Act") and Rule 10b-5, 17 C.F.R. § 240.10b-5 ("Rule 10b-5") promulgated thereunder (collectively, "Section 10(b)").[2]

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[1] The Institute's brief is submitted on written consents of the parties, which have been filed contemporaneously herewith.

[2] The Institute was invited to and did testify before the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act. *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate*, 73d Cong., 1st Sess., pt. 15 at 7207-10 (1934). The Institute has also participated as *amicus curiae* in a number of cases in this Court concerning related securities laws issues, including *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085 (1993).

The questions presented in this case transcend the interests of the parties and are of particular importance to the Institute and its members. The recognition and expansive application by the lower courts of an implied private cause of action for aiding and abetting a violation of Section 10(b) has resulted in an uncontrolled and incoherent expansion of secondary liability against accountants and other professional service providers for conduct that, by definition, does not constitute a primary violation of that provision. Accountants, whose role in auditing and reporting on the financial statements of public companies makes them inviting "deep pocket" targets, are routinely sued for aiding and abetting under the statute.

The resultant liability explosion has greatly increased the costs of accounting services and has forced many mid-sized and small accounting firms to cease or curtail providing auditing services. Even the largest accounting firms have refrained from providing such services to new technology and other high-risk industries for fear of Section 10(b) litigation. In light of these severe consequences, the Institute and its members are greatly interested in this Court's review of the questions presented herein.

INTRODUCTION AND SUMMARY OF ARGUMENT

A.

Recognizing an implied private cause of action for aiding and abetting under Section 10(b) would by definition impose liability, based on conduct which, standing alone, does not constitute a violation of the statute, upon persons whom the statute by its terms does not reach. The two questions presented in this case actually provide alternative ways of addressing what is essentially a single issue: whether persons who engage in certain acts which in and of themselves do not violate Section 10(b), and who are not in a statutorily-established class of persons derivatively liable by virtue of status, may nonetheless be liable under the statute for those acts.

The more direct, doctrinally sound, and efficient approach would be to recognize that there is simply no

warrant in the language or structure of Section 10(b) to engraft upon it an implied cause of action for aiding and abetting a violation of its terms. A somewhat less effective approach would permit finding liability for aiding and abetting only when a defendant actually knows that wrongful activity violative of Section 10(b) is being committed and intentionally provides substantial assistance to the primary violator in perpetrating the scheme.

In most cases, there would be little, if any, difference in outcome between the two approaches, since the standard of *scienter* proposed would make a defendant liable only if its conduct was tantamount to at least an "indirect" primary violation. The Institute submits, nevertheless, that fidelity to the techniques of statutory analysis announced by this Court, a proper concern for clarity and coherence in defining the scope of liability-producing statutes, and clear advantages in efficiency and policy favor rejection of an implied aiding and abetting cause of action under Section 10(b).

B.

This Court's recent decision in *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 113 S. Ct. 2085, 2088-89 (1993), holds that there are two modes of analysis which may apply in determining whether a cause of action should be implied under Section 10(b). Under either mode, no cause of action for aiding and abetting can be implied here. If, as the Institute submits, recognition of an implied private right of action for aiding and abetting would create a new cause of action, then the traditional inquiries into the statutory text, scheme, and legislative purpose must be made. If, on the other hand, resolution of the issue is viewed as a matter of defining the contours of the existing implied right of action for primary violations of Section 10(b), reference must be made to the other express liability provisions of the 1933 and 1934 Acts to determine how Congress would have addressed aiding and abetting liability had it considered the issue.

There is no evidence, under either mode of analysis, that Congress intended to impose liability under Section 10(b) for any conduct beyond the statute's express prohibitions.

Neither Section 10(b) nor Rule 10b-5 imposes liability or provides any express remedy for aiding and abetting, and the underlying structure of the 1934 Act's statutory scheme negates the existence of such liability. Moreover, none of the other express civil liability provisions in the 1933 and 1934 Acts, including those this Court has found most analogous to Section 10(b), provides for aiding and abetting liability. The lack of any express private civil remedy for aiding and abetting in the federal securities laws strongly suggests that Congress would not have imposed such liability under Section 10(b) had it considered the issue.

C.

Because Congress has not expressly authorized aiding and abetting liability, if the Court were to recognize such a private cause of action, it should exercise caution in establishing the scope of such liability. In that case, the same canons of statutory construction used to define the *scienter* requirements of a primary violation would require both *actual knowledge* of a primary violation and a *conscious intent* to assist substantially in that violation before aiding and abetting liability can attach under Section 10(b). These stringent *scienter* requirements will ensure that a sufficient nexus exists between the alleged aider and abettor's conduct, which itself is, by hypothesis, not actionable under Section 10(b), and the "manipulative or deceptive" acts proscribed by the statute. And they will tend to limit the risks to coherent, consistent, and predictable application of the law inherent in any recognition of aiding and abetting liability by restricting exposure to those defendants who have engaged in truly egregious conduct in furtherance of a Section 10(b) violation.

ARGUMENT

I. A PRIVATE CAUSE OF ACTION FOR AIDING AND ABETTING UNDER SECTION 10(b) WAS NOT INTENDED BY CONGRESS AND SHOULD BE REJECTED BY THIS COURT.

Recognition of an implied private cause of action for aiding and abetting under Section 10(b) would expand dramatically the class of conduct that could give rise to liability under the statute. Indeed, the sole reason for recognizing liability for aiding and abetting is to reach conduct that does not constitute a primary violation of Section 10(b). At the heart of this case, therefore, is the question whether Congress intended to impose liability under Section 10(b) for conduct which itself is not expressly prohibited, on a party who is not, by category or classification, within the class of wrongdoers that have been recognized to be covered by the statute.[3]

This Court has twice reserved the question whether civil liability for aiding and abetting is appropriate under Section 10(b) and Rule 10b-5, and, if so, the elements necessary to establish such a cause of action. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 191-92 n.7 (1976); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983). In the absence of a ruling by this Court, the Tenth Circuit and other lower federal courts have assumed the existence of aiding and abetting as a separate cause of action, permitting recovery under Section 10(b) from parties who themselves have not violated the statute, but who have allegedly assisted another in doing so. The lower courts have borrowed from criminal and common law tort concepts of aiding and abetting in recognizing this cause of action, with little or no attempt to address

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[3] In this regard, aiding and abetting is distinguishable from other types of secondary liability, such as *respondeat superior* and controlling person liability, which involve the question whether certain parties may be held vicariously liable for a primary violation on the basis of their status or relationship to the primary violator. Aiding and abetting, in contrast, involves the creation of a new class of conduct for which liability may be imposed.

whether Congress ever intended to create liability for aiding and abetting under Section 10(b). *See* Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 93-94 (1981) ("*Secondary Liability*").

That analysis is plainly inadequate to justify expanded liability under Section 10(b). This Court has long instructed that the existence of an implied private right of action is a question of congressional intent, and that reliance on tort principles to resolve that question "is entirely misplaced." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979).

The Court's recent decisions in *Musick, Peeler*, 113 S. Ct. at 2087-89, *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2763-64 (1991), and *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2780 (1991), set forth a two-step process for adjudicating questions involving causes of action implied under the federal securities laws. Where the question is whether to recognize a new cause of action, the Court has held it will do so only upon a showing of clear congressional authorization, stating that "the creation of new rights ought to be left to legislatures, not courts." *Musick, Peeler*, 113 S. Ct. at 2088. The Court will therefore look for demonstrative evidence in the statutory text and scheme that Congress intended to create such a right. *See id.; Virginia Bankshares*, 111 S. Ct. at 2764.

Where the question at issue does not involve the creation of a new cause of action, but rather involves elaboration of the scope of an action already implied by the judiciary, the Court will look to the most analogous express causes of action contained in the securities laws to determine how Congress would have resolved the question had it considered providing the private right of action when enacting the statute. *Musick, Peeler*, 113 S. Ct. at 2090.

Whether aiding and abetting liability be considered a new cause of action or an amplification of the contours of an existing one, it cannot survive the analyses required by this Court's decisions.

A. Recognizing Aiding And Abetting Liability Under Section 10(b) Would Create A New Cause Of Action, For Which There Is No Evidence Of Congressional Intent.

1. *Implied Aiding And Abetting Liability Would Be A New Cause Of Action.*

In its most recent decisions addressing the scope of private damages actions implied by the courts under the federal securities laws, this Court has drawn a careful distinction between expanding the scope of damages liability beyond its existing limits and "fleshing out" the contours of the liability already recognized by this Court. In *Musick, Peeler*, for example, the question was whether persons jointly liable for damages under Section 10(b) may seek contribution from one another. The Court recognized that "the creation of new rights ought to be left to legislatures, not the courts." 113 S. Ct. at 2088. It concluded, however, that the claim in contribution did not constitute a "new right[]" because the defendants in contribution already were subject to damages liability for primary violations of Section 10(b) under the Court's existing jurisprudence. *Id.*

As explained by the Court, "[t]he parties against whom contribution is sought are . . . persons or entities alleged to have violated existing securities laws *and who share joint liability for that wrong under a remedial scheme established by the federal courts.*" *Id.* (emphasis added). The duty in question was "but the duty to contribute for having committed a wrong that courts have already deemed actionable under federal law." *Id.*

Significantly, the Court stated that the argument that contribution constituted a new cause of action—and therefore was proper only if expressly authorized by Con-

gress—"would have much force were the duty to be created . . . one governing conduct not already subject to liability through private suit." *Id.* It was the fact that the case involved the allocation of damages "among persons or entities already subject to . . . liability" that allowed the Court to permit contribution claims in the absence of clear congressional authorization. *Id.*

The question whether an implied private cause of action for aiding and abetting should be recognized under Section 10(b) falls squarely on the other side of the line drawn by this Court in *Musick, Peeler*. The sole reason for allowing a cause of action for aiding and abetting is to impose liability on persons *not* subject to liability under the standards set forth in this Court's prior decisions. By recognizing such a cause of action, therefore, the Court would be creating a new species of liability for "conduct not already subject to liability through a private suit," precisely the situation in which *Musick, Peeler* indicates that congressional authorization is required, so that the Court may avoid trenching on the prerogatives of the legislative branch. *Id.*

This conclusion is reinforced by the Court's reasoning in *Virginia Bankshares*, 111 S. Ct. 2749 (1991). There, the Court viewed a proposed relaxation of the causation requirements of an implied private cause of action under Section 14(a) as an "expansion" or "extension" of liability that could only be justified by a clear manifestation of congressional intent. *Id.* at 2763. Although a substantial number of lower courts had adopted the more expansive causation theory, the Court admonished that "the legitimacy of any such extension or expansion . . . must ultimately rest on congressional intent to provide a private remedy." *Id.* (citing *Touche Ross*, 442 U.S. at 575). After finding "no manifestation of [congressional] intent to recognize a cause of action (or class of plaintiffs) as broad as [the] respondents' theory of causation would entail," the Court refused to recognize the proposed new theory and rejected the lower court decisions adopting it. *Id.* at 2763, 2765.

Aiding and abetting liability, by its very nature, would extend and expand the class of persons subject to suit under Section 10(b). For the reasons enunciated in *Musick, Peeler* and *Virginia Bankshares*, therefore, recognition of aiding and abetting liability under Section 10(b) would constitute a new cause of action, requiring a clear manifestation of congressional intent.

2. *There Is No Evidence Of Any Congressional Intent To Provide A Private Civil Damages Remedy For Aiding And Abetting A Violation Of Section 10(b).*

The requisite congressional intent to create a private cause of action for aiding and abetting a primary violation of Section 10(b) is clearly lacking. This Court repeatedly has recognized that Congress did not intend to provide for private actions against primary violators when it enacted the statute.[4] *See Lampf, Pleva*, 111 S. Ct. at 2779-80 (private action is "of judicial creation"); *accord Musick, Peeler*, 113 S. Ct. at 2088. It is indisputable, therefore, that Congress did not intend to create a private action against aiders and abettors. Even if Congress had included in Section 10(b) a substantive provision against aiding and abetting (so that, for example, the SEC could proceed against aiders and abettors pursuant to its separate statutory power to seek injunctive relief for any violations of the 1934 Act), that would not have manifested an intent by Congress to authorize private actions against aiders and abettors; and Congress, of course, did not even go that far. In the absence of the requisite congressional intent, this Court should not recognize such a new cause of action.

Moreover, there is considerable evidence that Section 10(b) does not even reach aiding and abetting.[5] " 'The

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[4] Because the questions presented here involve analysis of whether a *private* cause of action for civil aiding and abetting should be implied under Section 10(b), such analysis does not implicate the SEC's enforcement powers or the bases of such powers.

[5] Of course, the Court need not resolve this question in order to conclude that Respondents may not maintain a *private* damages

starting point in every case involving construction of a statute is the language itself.'" *Ernst & Ernst*, 425 U.S. at 197 (citations omitted). Section 10(b) provides that "[i]t shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance . . . ." 15 U.S.C. § 78j(b). The statute does not expressly prohibit aiding and abetting, and Rule 10b-5 is equally silent on the issue. The absence of any express language making it unlawful to aid and abet violations of Section 10(b) thus "is strong evidence that Congress did not intend to impose such liability upon conduct which would not otherwise be prohibited as a 'manipulative or deceptive practice.'" *Secondary Liability*, 69 Cal. L. Rev. at 95.

This Court in other contexts has carefully limited the contours of Section 10(b) to conduct expressly proscribed by the statute. In *Ernst & Ernst*, 425 U.S. at 200-02, 212, for example, this Court held that the "manipulative or deceptive" language of Section 10(b) embraces intentional conduct only, thus requiring a showing of *scienter*. In so holding, the Court stated, in words of particular import here, that "[w]hen a statute speaks so specifically in terms of manipulation and deception . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute." *Id.* at 214. The Court repeated these very same words in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74 (1977), reaffirming that the language of Section 10(b) "gives no indication that Congress meant to prohibit any conduct . . . [that cannot] be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." Similarly, in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 749 (1975), this Court held that the plaintiffs were not entitled to sue for alleged violations of Rule 10b-5, because they were neither "purchasers" nor "sellers" within the meaning of Section 10(b). The rationale

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action against aiders and abettors. The absence of congressional authorization of private actions is dispositive of that issue.

adopted by the Court in *Blue Chip Stamps* for refusing to expand the ambit of plaintiffs who could sue on the basis of conduct not covered by the statute equally supports the view that the Court should not expand the ambit of defendants who can be sued for conduct not covered by the statute. By holding that the scope of Section 10(b) cannot be extended to conduct it does not expressly proscribe, these precedents make clear that the statute allows no room for aiding and abetting, which by its very nature involves conduct that the statute itself does not expressly proscribe.

Finally, the statutory scheme of the 1934 Act further negates any intent by Congress to reach aiding and abetting under Section 10(b). In contrast to Section 10(b), Congress has provided explicit statutory authority for addressing aiding and abetting offenses in other provisions of the federal securities laws. For example, Section 15(b)(4)(E) of the 1934 Act (15 U.S.C. § 78o(b)(4)(E)) expressly authorizes the SEC to discipline a broker or dealer who "has willfully aided [or] abetted . . ." violations of the securities laws. Congress' express treatment of aiding and abetting liability in the context of this administrative enforcement provision demonstrates, in the words of this Court, that "when Congress wished to provide [such a] remedy, it knew how to do so and did so expressly." *Touche Ross*, 442 U.S. at 572.[8]

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[8] Further evidence of Congress' ability to legislate express remedies for aiding and abetting is found in other provisions of the federal securities laws. Section 203(e)(5) of the Investment Advisers Act, 15 U.S.C. § 80b-3(e)(5), for example, authorizes the SEC to discipline investment advisers and companies that aid or abet securities laws violations. Section 9(b)(3) of the Investment Company Act, 15 U.S.C. § 80a-9(b)(3), similarly empowers the SEC to bar from service with any investment company or related organization any "willful" aider or abettor of a securities violation. The Commodity Exchange Act (the "CEA") contains like provisions for administrative discipline based on aiding and abetting. *See* 7 U.S.C. § 12a(2)(E)(ii) (denial or revocation of registration); 7 U.S.C. § 12a(3)(A) (denial of registration); 7 U.S.C. § 12a(3)(K)(ii) (same); 7 U.S.C. § 12a(4) (refusal, revocation,

The absence of any such express reference in Section 10(b), and in the other provisions of the 1934 Act that it resembles (*see* page 13, *infra*), provides strong evidence that Congress did not intend Section 10(b) to reach aiding and abetting.[7]

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modification, or restriction of registration). Section 13c(a) of the CEA further provides that "[a]ny person . . . who willfully aids [or] abets . . . a violation of [the Act] . . . may be held responsible for such violation as a principal." 7 U.S.C. § 13c(a).

[7] The point is emphasized by considering what Congress chose *not* to do. An effort was made in 1959 to amend the statutory scheme of the 1934 Act to make it unlawful "for any person to aid [or] abet . . . the violation of any provision of the [1934 Act] or rule or regulation thereunder." H.R. 5001 and S. 1178, 86th Cong., 1st Sess. (1959), *reprinted in Securities Acts Amendments, 1959: Hearings on H.R. 5001 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 86th Cong., 1st Sess. 89, 103 (1959). In response to industry representatives' fears that the proposed legislation would result in the imposition of secondary liability in private suits, the SEC agreed to clarify the bill to indicate that "no civil liability is intended." *SEC Legislation: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 86th Cong., 1st Sess. 288, 292 (1959). The SEC position was a plain indicator that the agency did not then believe that the already existing terms of the statute created civil liability for aiding and abetting. The proposed legislation was never enacted. The similar history of a companion provision in the 1959 legislative package was considered pertinent by the Court in *Blue Chip Stamps*, 421 U.S. at 732-33, in concluding that Congress had not intended to expand the cause of action under Section 10(b) beyond "purchasers" and "sellers."

Notably, contemporaneous legislation was enacted amending the Investment Advisers Act to empower the SEC to exercise its enforcement powers against aiders and abettors. Amendments to Investment Advisers Act of 1940, Pub. L. No. 86-750, 74 Stat. 885 (Title 15, § 209(e)) (current version at 15 U.S.C. § 80b-9(d) (1988)).

Taken as a whole, this legislative history demonstrates that, when Congress considered the issue of aiding and abetting in the context of the securities laws, it deliberately restricted the scope of liability to administrative enforcement actions and chose not to provide private damages actions for such conduct.

B. Aiding And Abetting Liability Cannot Be Imputed As A "Contour" Of The Existing Private Right Of Action For Primary Violations Of Section 10(b).

Even if aiding and abetting liability were not considered as a new cause of action, but rather as a "contour" of the existing Section 10(b) action, there is no indication Congress would have imposed such liability had it considered the question. In "rounding out" the scope and elements of Section 10(b) liability, the Court has sought "to ensure that the rules established to govern the 10b-5 action are symmetrical and consistent with the overall structure of the Act and, in particular, with those portions of the Act most analogous to the private 10b-5 right of action that is of judicial creation." *Musick, Peeler*, 113 S. Ct. at 1090. Where there is "convincing" evidence of what Congress would have done had it known that Section 10(b) would be the basis for a private cause of action, the Court will shape the implied cause of action in accord with that evidence. *Id.* An examination of the provisions most analogous to Section 10(b) confirms that there is no basis for creating a civil remedy for aiding and abetting under the statute.

The Court has previously found that Sections 9 and 18 of the 1934 Act (15 U.S.C. §§ 78i and 78r) "are clos[est] in structure, purpose and intent to the 10b-5 action." *Musick, Peeler*, 113 S. Ct. at 2090; *Lampf, Pleva*, 111 S. Ct. at 2781. As explained by the Court, the two provisions are of "particular significance in determining how Congress would have resolved" questions concerning the contours of Section 10(b) liability, because they not only "target the precise dangers that are the focus of § 10(b)," *Lampf, Pleva*, 111 S. Ct. at 2781, but also "impose liability upon defendants who stand in a position most similar to 10b-5 defendants . . . ." *Musick, Peeler*, 113 S. Ct. at 2090. Given the significance of these provisions to the Section 10(b) analysis, it is critically relevant that neither Section 9 nor Section 18 provides a private cause of action for aiding and abetting. This fact

alone requires rejection of any implied liability for aiding and abetting.[8]

Moreover, in construing these analogous liability provisions, courts have generally concluded that they do not impose aiding and abetting liability. Only one reported case has expressly recognized aiding and abetting liability under Section 18. *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366 (S.D.N.Y. 1973). The court justified such liability in that case by reference to the "broad, remedial nature" of the federal securities laws. *Id.* at 382. That rationale, doubtful in 1973, is clearly obsolete twenty years later, since this Court has repeatedly held in the intervening decades that these remedial goals do not justify imposing liability under a statute " 'more broadly than its language and the statutory scheme reasonably permit.' " *Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (citations omitted). Probably in light of this now settled jurisprudence, no court since *Caesars Palace* has imposed aiding and abetting liability under Section 18.

There similarly has been no significant consideration of aiding and abetting liability under Section 9. The Institute is aware of only one reported case in which aiding and abetting liability was imposed, without analysis, under that provision as part of a larger Section 10(b) action. *See Sennott v. Rodbart*, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,851 (N.D. Ill. 1970). The decision was subsequently reversed by the Seventh Circuit on the ground that there was no evidence the alleged aiders and abettors had knowledge of the underlying securities violations. *Sennott v. Rodman & Renshaw*, 474 F.2d 32, 39 (7th Cir.), *cert. denied*, 414 U.S.

[8] None of the remaining six express liability provisions of the 1933 and 1934 Acts provides such a remedy. These provisions include Sections 11, 12, and 15 of the 1933 Act (15 U.S.C. §§ 77k, 77*l*, and 77o), and Sections 16, 20, and 20A of the 1934 Act (15 U.S.C. §§ 78p, 78t, and 78t-1).

926 (1973). Having made this factual determination, the Seventh Circuit had no occasion to address the question whether there is an implied private cause of action for aiding and abetting under Section 9.

Among the other express liability provisions of the federal securities laws, *see* note 8, *supra*, the only notable discussion of aiding and abetting liability has centered on Sections 11 and 12 of the 1933 Act. The relevant cases reveal a strong judicial trend toward rejecting aiding and abetting liability under these provisions, as well. Most of the courts that have considered the issue under Section 11 have concluded that the statute's plain language does not impose aiding and abetting liability.[9] This result is consistent with the Court's decision in *Herman & MacLean v. Huddleston*, 459 U.S. at 382 n.13, which held that "[a] § 11 action can be brought only against certain parties such as the issuer, its directors or partners, underwriters, and accountants who are named as having prepared or certified the registration statement."

This Court's decision in *Pinter v. Dahl*, 486 U.S. at 651, strongly suggests that there is also no aiding and abetting liability under Section 12. At issue in *Pinter* was whether a long line of lower court decisions had properly extended primary liability under Section 12(1) beyond traditional defendant-sellers, as defined in the Act, to others " 'whose participation in the buy-sell transaction [was] a substantial factor in causing the transaction to take place.' " *Id.* at 649 (citations omitted). By rejecting the proposed "substantial factor" test and restricting liability to "sellers," the Court negated the viability of aiding and abetting liability under the statute.[10]

[9] *See, e.g., Hagert v. Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1034 (D. Minn. 1981); *McFarland v. Memorex Corp.*, 493 F. Supp. 631, 642 (N.D. Cal. 1980); *In re Equity Funding Corp. of America Sec. Litig.*, 416 F. Supp. 161, 181 (C.D. Cal. 1976).

[10] Although the Court declined to address whether the same restrictions applied to Section 12(2), courts have almost uniformly denied the existence of aiding and abetting liability under that provision as well. *See, e.g., Ackerman v. Schwartz*, 947 F.2d 841

In short, neither the analogous liability provisions of the 1933 and 1934 Acts nor the weight of the case authorities construing those provisions provides any evidence that Congress would have created a private cause of action for aiding and abetting under Section 10(b) had it considered the issue. There is simply no basis for implying such a right as part of the "contour" of the existing Section 10(b) cause of action.

Thus, unlike *Musick, Peeler* and *Lampf, Pleva,* where the statutory scheme revealed with clarity what Congress would have done with respect to the Section 10(b) cause of action, there is no "convincing" evidence here that Congress would have authorized private actions against aiders and abettors. Given the expansion in liability that would result from permitting such claims, and the absence of any clear congressional directive authorizing them, the Court should stay its hand. If Congress believes that this additional category of liability is a necessary supplement to the existing Section 10(b) action and the other actions under the federal securities laws, Congress can make appropriate provision for it.[11]

(7th Cir. 1991); *Craftmatic Sec. Litig. v. Kraftsow,* 890 F.2d 628 (3d Cir. 1989); *Wilson v. Saintine Exploration & Drilling Corp.,* 872 F.2d 1124 (2d Cir. 1989).

[11] The fact that aiding and abetting has gained some recognition under tort law does not provide any basis for expanding the Section 10(b) action to encompass such claims. This Court repeatedly has rejected the contention that Section 10(b) incorporates the standards governing common law tort liability. "[T]he typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable." *Blue Chip Stamps,* 421 U.S. at 744-45; *see also id.* at 747-49 (refusing to construe Section 10(b) action in accordance with common law); *Basic Inc. v. Levinson,* 485 U.S. at 244 n.22 ("[a]ctions under Rule 10b-5 are distinct from common-law deceit and misrepresentation claims"). In the absence of any indication that Congress would have authorized aiding and abetting claims, therefore, there is no warrant for incorporating this aspect of the common law into the private action implied under Section 10(b).

C. Aiding And Abetting Liability Exposes Accountants And Other Third Parties To Disproportionate Liability, Disrupts The Provision Of Vital Professional Services To The Public, And Raises Other Serious Policy Issues Never Addressed By Congress.

The practical consequences of allowing for the imposition of aiding and abetting liability under Section 10(b) raise a number of serious policy questions never addressed by Congress. In the absence of clear congressional intent, these policy concerns weigh heavily against implication of a private cause of action for aiding and abetting, whether as a new cause of action or as an expansion of the existing private right. *See Blue Chip Stamps,* 421 U.S. at 737; *Ernst & Ernst,* 425 U.S. at 214-15 n.33.

Experience teaches that among the most obvious targets of civil aiding and abetting accusations in securities actions are those professionals who provide necessary ancillary services to principal actors in the marketplace. There has been a flood of class action lawsuits and other cases in which accountants and other professionals have been required to defend through costly discovery or trial against claims of aiding and abetting. Accountants are often viewed as attractive defendants by plaintiff investors searching for the most solvent "deep pocket" they can find. *See* Lochner, *Black Days for Accounting Firms,* Wall St. J., May 22, 1992, at A10, col. 4; Mednick, *Accountants' Liability: Coping with the Stampede to the Courtroom,* J. Acct., Sept. 1987, at 118. The effects of this litigation explosion on the accounting profession have been "particularly acute," 138 Cong. Rec. S12,604 (daily ed. Aug. 12, 1992) (statement of Sen. Sanford on S. 3181, Securities Private Enforcement Act of 1992), resulting in virtually limitless liability, high insurance premiums, and the increasing unavailability of insurance. *See, e.g.,* Gossman, *The Fallacy of Expanding Accountants' Liability,* 1 Colum. Bus. L. Rev. 213, 215, 228-31 (1988); Minow, *Accountants' Liability and the Litigation Explosion,* J. Acct., Sept. 1984, at 70.

In commenting on the explosion of securities fraud litigation against accounting firms, Senator Sanford (for himself and Senator Domenici) noted that "[t]he mounting evidence simply does not support the notion that most of this litigation is meritorious." 138 Cong. Rec. S12,599, S12,605. To the contrary, of all 10b-5 actions filed against the six largest accounting firms which concluded in 1991, the total amount of settlements and judgments paid by the firms was only 3 percent of the claimed damages. *Id.* at S12,605. While these results underscore the weakness of such claims, in 83 percent of the cases the accounting firms were required to pay $8 in legal fees for every $1 ultimately paid to the plaintiffs. *Id.*

In recent testimony before the Securities Subcommittee of the United States Senate Committee on Banking, Housing and Urban Affairs, the Chairman of the Institute reflected on the continuing severe consequences expanded Section 10(b) liability has had on the accounting profession. *Hearings on Private Litigation Under the Federal Securities Laws*, 103d Cong., 1st Sess. (July 21, 1993) (statement of Jake L. Netterville, Chairman of the Board of Directors, American Institute of Certified Public Accountants). After noting that independent auditors often settle even frivolous 10b-5 suits due to the potential for joint and several liability and the "enormous" defense costs associated with such suits,[12] Mr. Netterville stated

[12] The accounting profession's experiences with settling even frivolous class action lawsuits are not atypical. As Judge Ralph K. Winter of the Second Circuit explained in the 1992 Holmes Lecture at Harvard Law School, "[b]ecause the motivation for bringing the action is the quest for attorney's fees, many such actions may be brought on the basis of their settlement value, which may be related more to the expected costs of defense than to the merits of the underlying claim." Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 949 (1993). *See also* Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991), which describes in detail the increasing pressure to settle securities actions on bases unrelated to their merits, and analyzes the erosion of the

that growing numbers of smaller and mid-sized accounting firms have stopped performing audits or significantly reduced such services. *Id.* at 5. The larger accounting firms have also been forced to focus their risk management efforts on "avoiding those clients and potential clients that present the greatest likelihood of litigation." *Id.* at 6. These clients are typically the start-up and growth companies "whose futures are least assured and whose stock prices are most volatile . . . . Yet these are the very entities our country looks to for technological innovation, the bulk of job creation, and future competitive strength." *Id.*

As this evidence demonstrates, the lower courts' recognition of aiding and abetting liability under Section 10(b) has, in the words of this Court, "extend[ed] to new frontiers the 'hazards' of rendering expert advice under the Acts," *Ernst & Ernst*, 425 U.S. at 214 n.33 (citations omitted), and opened the door to the very type of "vexatious litigation" the Court warned against in *Blue Chip Stamps*, 421 U.S. at 742-43. It has forced accountants and other professionals to restrict their services, significantly increased the costs of ordinary securities transactions, and disrupted the free flow of financial information so critical in today's increasingly complex financial marketplace. Congress surely never intended such results when it struck the careful balance between full and fair disclosure of material information and efficient operation of the securities markets reflected in Section 10(b) and the other provisions of the federal securities laws. In light of these serious policy considerations, this Court should decline to embrace aiding and abetting liability and instead defer to Congress on the matter.

D. Other Remedies Are Available To Redress Accountant Misconduct.

Aiding and abetting liability is neither an exclusive nor necessary remedy for misconduct by accountants. Ac-

normative authority of the laws such actions are meant to enforce that is implicit in the trend.

countants who engage in "manipulative or deceptive" practices with respect to securities transactions may be fully liable for primary violations of Section 10(b). Other provisions of the federal securities laws,[13] various state laws, as well as actions for common law fraud and negligence,[14] provide additional remedies for alleged accountant misconduct. Professional standards imposed by state regulatory authorities and the Institute establish further enforcement mechanisms to redress improper behavior. *See* AICPA & NASBA Digest of State Accountancy Laws and State Board Regulations 1987-88 (1988); *Principles of Professional Conduct,* AICPA Professional Standards §§ 50-57 (Am. Inst. of Certified Pub. Accountants June 1, 1991). Refusal by this Court to recognize an implied private cause of action for aiding and abetting, therefore, will not leave private litigants or the SEC without adequate alternative remedies, or the public interest unprotected.

II. TO THE EXTENT THIS COURT RECOGNIZES AN IMPLIED PRIVATE CAUSE OF ACTION FOR AIDING AND ABETTING, IT SHOULD REQUIRE A SHOWING OF ACTUAL KNOWLEDGE OF THE PRIMARY VIOLATION AND A CONSCIOUS INTENT TO ASSIST IN ITS ACHIEVEMENT.

Should this Court decide to imply a private cause of action for aiding and abetting under Section 10(b), the Court should reject the recklessness standard adopted below and instead require a showing of actual knowledge of the primary violation and a conscious intent to assist substantially in its achievement in order to satisfy the *scienter* requirement for aiding and abetting.[15]

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[13] *See, e.g.*, 15 U.S.C. § 77k(a)(4) (imposing liability on accountants and other professionals, in certain circumstances, for misrepresentations in financial statements included in registration statements).

[14] *See* Haft, *Liability of Attorneys and Accountants for Securities Transactions* §§ 5.01-5.04 (1992).

[15] This Court has previously reserved the question whether recklessness may suffice, under certain circumstances, to establish *scienter* under Section 10(b). *See Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980); *Ernst & Ernst*, 425 U.S. at 194 n.12. As long as the Court determines that recklessness is insufficient to establish *scienter* for aiding and abetting liability under the statute, it need not reach the issue of whether recklessness suffices to establish the requisite *scienter* for a primary violation. A finding by this Court that recklessness is sufficient to show *scienter* for aiding and abetting, on the other hand, would necessarily require the Court to address the sufficiency of recklessness for proving a primary violation.

Although the federal circuits have adopted varying formulations of the elements for aiding and abetting under Section 10(b), generally speaking they are: (1) a violation of Section 10(b) by a primary party (as opposed to the alleged aider and abettor); (2) knowledge of that violation on the part of the alleged aider and abettor; and (3) the knowing rendering of substantial assistance by the alleged aider and abettor in achieving the primary violation.[16]

Because aiding and abetting liability stems from a separate primary violation, proving the offense necessarily requires evidence of two distinct mental states, as reflected in the second and third elements: There must be some degree of knowledge of the primary violation, coupled with some degree of knowledge of the aider and abettor's role in assisting that violation. The Institute respectfully urges this Court to address both mental states in determining the *scienter* requirements for aiding and abetting liability. Moreover, because aiding and abetting liability is one step removed from a primary violation and greatly expands the class of persons subject to suit, the Institute believes that stringent *scienter* requirements should be adopted for aiding and abetting to ensure a sufficient nexus exists between the conduct giving rise to such liability and the conduct actually proscribed in Section 10(b).

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[16] These elements are essentially derived from the Restatement (Second) of Torts § 876(b) (1979), which establishes joint tortfeasor liability for anyone who substantially assists in the commission of a tort. *See* Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examinaiton*, 52 Alb. L. Rev. 637, 647 (1988).

A. The Lower Courts Have Improperly Relied Upon Common Law Tort Principles In Embracing A Recklessness Standard.

The recklessness standard adopted by the lower courts, like the concept of aiding and abetting liability itself, is primarily derived from the common law of torts. Virtually every court that has considered the issue has held that recklessness is sufficient to establish *scienter* both for primary violations of Section 10(b) and for aiding and abetting under varying conditions.[17]

This Court's decisions in *Ernst & Ernst*, 425 U.S. at 197-202, and *Aaron v. SEC*, 446 U.S. 680, 689-95 (1980), however, make clear that, in determining the level of *scienter* necessary to prove a Section 10(b) offense, resort must be made to "the plain meaning of the language of § 10 (b)," the statute's legislative history, and "the structure of the civil liability provisions in the 1933 and 1934 Acts." *Aaron*, 446 U.S. at 690. Reliance on these principles of statutory construction led the Court in *Aaron* to conclude that *scienter* is a necessary element in Section 10(b) injunctive proceedings brought by the SEC, even though the common law analogues of fraud do not require a showing of *scienter* in cases where injunctive relief is sought. *Id.* at 694-95. *See also Blue Chip Stamps*, 421 U.S. at 744-45 (classic tort law "light years away from" modern Section 10(b) action). To the extent that reference to the text and scheme of Section 10(b) is inconclusive, the Court has further instructed that it will look "to policy reasons for deciding where the outer limits of the right should lie." *Virginia Bankshares*, 111 S. Ct. at 2764 (citing *Blue Chip Stamps*, 421 U.S. at 737).

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[17] *See* Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 Cin. L. Rev. 667, 674 n.22 (1991) (collecting cases and relevant law review articles and treatises).

B. This Court Should Adopt Stringent *Scienter* Standards Which Closely Tie The Alleged Aiding And Abetting Conduct To The Underlying Statutory Violation.

The plain language of Section 10(b), its statutory scheme, and relevant policy considerations strongly support the adoption of stringent *scienter* requirements which closely tie aiding and abetting liability to the "manipulative and deceptive" practices proscribed by Congress. The common law-based recklessness standard urged by Respondents, in contrast, extends liability under Section 10(b) far beyond the statutory concern.

1. *The Language Of Section 10(b) Supports Heightened* Scienter *Requirements For Aiders And Abettors.*

In *Ernst & Ernst*, the Court held that the plain meaning of the terms "manipulative," "device," and "contrivance" in Section 10(b) evince an "unmistakable" congressional intent to proscribe only "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." 425 U.S. at 199 & nn. 19-20. Later, in *Santa Fe Indus.*, the Court reaffirmed that "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." 430 U.S. at 473.

The word "manipulative," the Court noted, is a term of art when used in connection with the securities markets and refers "generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Id.* at 476 (citations omitted). Although the Court had "[n]o doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices," *id.* at 477, the Court concluded that Congress would not have chosen this "term of art" if it intended to bring within the scope of Section 10(b) every type of fraud, breach of fiduciary duty, or other misconduct that might arise in the context of a securities trans-

action. Thus, the Court held that a complaint states a cause of action under Section 10(b) "only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Id.* at 473-74.

A private cause of action for aiding and abetting would implicate, to a much greater degree, the Court's concerns with restricting liability under Section 10(b) to conduct expressly proscribed by Congress. By its very nature, aiding and abetting extends liability beyond a violation of the statute itself to reach conduct which otherwise would not be actionable. Aiding and abetting liability is thus divorced from the statutory language and, if not properly grounded, may be (and has been) extended to sweep in broad classes of conduct that Congress never intended to address in the statute. Just as this Court has not allowed Section 10(b) to be expanded to cover all conduct related in some way to a securities transaction, this Court should reject any standard of liability which allows such an expansion through the back door of aiding and abetting. By adopting stringent *scienter* requirements, this Court can require the necessary nexus between the "manipulative" and "deceptive" acts Congress intended to proscribe in Section 10(b) and the conduct giving rise to an independent claim of aiding and abetting.

First, because aiding and abetting liability is predicated on the conduct of a primary violator, a plaintiff should be required to show that the alleged aider and abettor had *actual knowledge* of the primary violation of Section 10(b). This knowledge requirement would properly limit aiding and abetting liability to those who knowingly involve themselves in the type of wrongful practices Congress intended to prohibit, thereby lessening the concerns that such involvement does not itself violate Section 10(b). Requiring fact-based allegations of actual knowledge of the underlying violation would also deter the now common practice by plaintiffs of naming virtually every participant in a securities transaction as an aider and abettor, no matter how remote their involvement in the alleged fraud. *See, e.g., Roberts v. Peat, Marwick,*

Mitchell & Co., 857 F.2d 646 (9th Cir. 1988), *cert. denied*, 493 U.S. 1002 (1989).

Second, because the rendering of "substantial assistance" in the underlying violation is not, in and of itself, actionable under Section 10(b), a plaintiff should be required to show that the alleged aider and abettor *consciously intended* to assist the primary violator in the conduct prohibited by the statute. Adoption of this conscious intent requirement would limit aiding and abetting liability to conduct that is clearly connected to an actual violation of Section 10(b), and would deter suits based on more remote conduct, for which there is no evidence Congress ever intended to impose liability under the federal securities laws.

The actual knowledge and conscious intent standards urged by the Institute would permit recovery against aiders and abettors in appropriate cases, while limiting the expansion of liability under Section 10(b) to conduct that more closely resembles the "manipulative and deceptive" practices Congress intended to proscribe under the statute. The common law-based recklessness standard urged by Respondents, on the other hand, would extend (and has extended) Section 10(b) liability to conduct that cannot, in the words of this Court, "be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Santa Fe Indus.*, 430 U.S. at 474.

Adoption of a recklessness standard by the lower courts has led to numerous extensions of Section 10(b) liability far beyond the conduct intended by Congress.[18] These

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[18] *See, e.g., Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301 (9th Cir. 1982) (extending aiding and abetting liability under recklessness standard to accounting firm for failure to uncover alleged backlog of inventory, even though firm had complied with generally accepted auditing standards which did not require accountants to audit or comment on such backlog); *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362 (D. Conn. 1987) (extending aiding and abetting liability under recklessness standard to law firm for failure to uncover alleged omissions in offering memorandum, even though firm had only assisted in preparation of drafts and made no representations about offering);

cases, which have made accountants and other professionals virtual guarantors against the issuer's fraud, demonstrate the need for the more stringent *scienter* standards urged by the Institute.[19]

2. *The Statutory Scheme Supports Heightened* Scienter *Requirements For Aiding And Abetting Liability.*

The statutory scheme also supports more stringent *scienter* requirements for aiders and abettors. Section 11(b) of the 1933 Act (15 U.S.C. § 77k(b)) provides an express private cause of action when a registration statement misrepresents or omits material facts. The issuer of the securities is strictly liable for any resulting damages. Professionals such as accountants who participated in the preparation of the registration statements, however, "are accorded a 'due diligence' defense." *Ernst & Ernst*, 425 U.S. at 208. Similarly, Section 15 of the 1933 Act (15 U.S.C. § 77o) and Section 20(a) of the 1934 Act (15 U.S.C. § 78t) impose secondary liability on "controlling persons," but provide a good faith defense to such liability. Section 11(e) of the 1933 Act (15 U.S.C. § 77k(e)) also authorizes the court to require a plaintiff bring-

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Mishkin v. Peat, Marwick, Mitchell & Co., 658 F. Supp. 271 (S.D.N.Y. 1987) (extending aiding and abetting liability under recklessness standard to accounting firm for failure to uncover issuer's alleged solvency problems during audit, even though plaintiff alleged no specific reliance on firm's audit report and conceded that firm had made no misrepresentations).

[19] In *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986), *LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928 (7th Cir.), *cert. denied*, 488 U.S. 926 (1988), and *Schlifke v. Seafirst Corp.*, 866 F.2d 935 (7th Cir. 1989), the Seventh Circuit held that, in addition to meeting the elements for aiding and abetting, an aider and abettor must have committed one of the "manipulative or deceptive" acts prohibited under Section 10(b) and Rule 10b-5 with the same degree of *scienter* required for primary liability. This approach demonstrates an attempt by the Seventh Circuit to construe the scope of liability for aiding and abetting under Section 10(b) in a manner more consistent with the express language of the statute and the congressional intent underlying it.

ing suit under Sections 11 or 15 to post a bond for costs, including attorneys' fees, and permits an award of costs under certain specified circumstances.

These provisions evince a clear intent by Congress to provide special procedural safeguards and defenses to secondary parties when imposing potential liability on them under the federal securities laws, whether on the basis of their relationship to the primary violator or on the basis of their own conduct in the securities transaction. In light of this statutory scheme, there is no reason to believe that Congress would not have provided similar safeguards had it determined to impose aiding and abetting liability on secondary parties under Section 10(b). The *scienter* standards urged by the Institute would provide such protections.

3. *Relevant Policy Considerations Weigh In Favor Of Stringent* Scienter *Standards For Aiding And Abetting.*

Adoption of more stringent *scienter* standards will also serve important policy objectives. Those considerations are discussed at pages 17-19, *supra*.

These higher standards will also tend to promote greater clarity, consistency, and coherence in the application of aiding and abetting liability under Section 10(b). *See Musick, Peeler*, 113 S. Ct. at 2090. As described by one commentator:

> [T]he courts have been less than precise in defining what exactly constitutes a reckless misrepresentation. That imprecision has resulted in ad hoc, if not arbitrary, recklessness determinations. . . . [T]he result is that actual and potential parties to Section 10(b) and Rule 10b-5 actions cannot predict with any degree of certainty how a trier of fact will characterize challenged conduct and thus whether it may serve as the basis for liability.

Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 Cin. L. Rev. 667, 674-75 (1991) (citing representative cases).

The mischief these varying recklessness standards have wrought in Section 10(b) cases is evidenced by the facts here. The Tenth Circuit held that recklessness is sufficient to show *scienter* for aiding and abetting, even in the absence of a duty to disclose or to act, where the defendant has engaged in "affirmative acts" which assisted the primary violation of Section 10(b). This holding conflicts with the standards adopted by the Second and Fourth Circuits, which hold that recklessness is insufficient to show *scienter* absent a duty to disclose. *See Ross v. Bolton,* 904 F.2d 819, 824 (2d Cir. 1990); *Schatz v. Rosenberg,* 943 F.2d 485, 496 (4th Cir. 1991), *cert. denied,* 112 S. Ct. 1475 (1992).

In further contrast, the Fifth, Eighth, and Eleventh Circuits have adopted a "sliding scale" approach, under which the requisite degree of *scienter* varies depending on whether the defendant owes a duty to disclose and on the nature of the defendant's conduct. *See, e.g., Woodward v. Metro Bank,* 522 F.2d 84, 95-97 (5th Cir. 1975); *Akin v. Q-L Invs., Inc.,* 959 F.2d 521, 526 (5th Cir. 1992) (following *Woodward* but criticizing its standard as "mushy and difficult to apply"); *Metge v. Baehler,* 762 F.2d 621, 624-25 (8th Cir. 1985), *cert. denied,* 474 U.S. 1057 and 474 U.S. 1072 (1986); *Schneberger v. Wheeler,* 859 F.2d 1477, 1480-81 (11th Cir. 1988), *cert. denied,* 490 U.S. 1091 (1989).

By requiring actual knowledge of the underlying violation and a conscious intent to assist in its achievement, as the Institute proposes, this Court will bring much needed guidance to accountants and others with respect to the scope of their potential liability for aiding and abetting under Section 10(b). These standards are more likely to be uniformly and objectively applied by the courts, and to prevent the type of "ad hoc, if not arbitrary, recklessness determinations" that have plagued this area of jurisprudence. Johnson, *Liability for Reckless Misrepresentations,* 59 Cin. L. Rev. at 674.

Heightened *scienter* requirements will also separate colorable aiding and abetting cases from class action strike

suits and other vexatious litigation in the type of "readily demonstrable manner" embraced by this Court in *Blue Chip Stamps,* 421 U.S. at 743. In explaining the need to adhere to stringent standing requirements in Section 10(b) cases, the Court expressed practical concerns in *Blue Chip Stamps* that are directly relevant here:

> Obviously there is no general legal principle that courts in fashioning substantive law should do so in a manner which makes it easier, rather than more difficult, for a defendant to obtain a summary judgment. But in this type of litigation, where the mere existence of an unresolved lawsuit has settlement value . . . because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial, such a factor is not to be totally dismissed.

Id. at 742-43.

The Institute has previously recounted the dramatic increase in defense costs and resulting disruption of services that aiding and abetting liability has caused to the accounting profession, even though the vast majority of cases have not been meritorious. The knowledge and conscious intent standards urged by the Institute will raise the pleading and proof requirements in aiding and abetting cases, thereby increasing the likelihood that actions with very little chance of success at trial will be resolved by dismissal or summary judgment. These more stringent standards also may deter frivolous nuisance suits from ever being filed. Should this Court conclude that a private cause of action for aiding and abetting is implied in Section 10(b), therefore, these *scienter* requirements will be critically important in ensuring that the resulting expansion of liability under the statute does not "ultimately result in more harm than good." *Blue Chip Stamps,* at 747-48.

C. In All Events, Recklessness Should Only Suffice To Prove *Scienter* Where There Is A Well Recognized, Clearly Defined Duty To Speak Or Act.

If this Court were to allow recklessness to suffice to prove *scienter* of an aider and abettor under Section 10(b), the Court should follow the majority of the circuits by strictly limiting the application of such a standard to cases where the aider and abettor has a well recognized, clearly defined duty to speak or act.

CONCLUSION

For the foregoing reasons, the Institute respectfully requests that this Court hold that there is no implied private cause of action for aiding and abetting violations of Section 10(b) and Rule 10b-5 or, to the extent this Court recognizes such a cause of action, that a showing of actual knowledge of the underlying violation and a conscious intent to assist substantially in its achievement be required to establish *scienter* for aiding and abetting liability.

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Dated: July 30, 1993